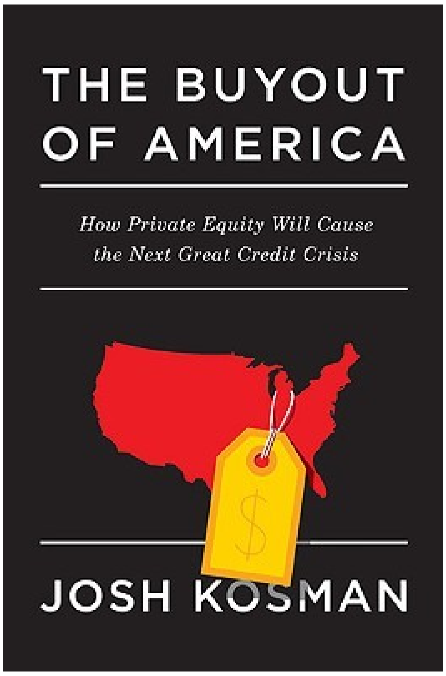

The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis

Joshua Kosman

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The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis Joshua Kosman
An authoritative exposé of the mysterious and potentially dangerous world of private equity.

Few people realize that the top private equity firms, such as Blackstone Group, Carlyle Group, and Kohlberg Kravis Roberts, have become the nation's largest employers through the businesses they own. Using leveraged buyouts that load their acquired companies with loans, private equity firms have generated more than $1 trillion in new debt—which will come due just when these businesses are least likely to be able to pay it off.

Journalist Josh Kosman explores private equity's explosive growth and shows how its barons wring profits at the expense of the long-term health of their companies. He argues that excessive debt and mismanagement will likely trigger another economic meltdown within the next five years, wiping out up to two million jobs.

He also explores the links between the private equity elite and Washington power players, who have helped them escape government scrutiny. The result is a timely book with an important warning for us all.

The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis Details

Date	:	Published November 12th 2009 by Portfolio Hardcover (first published 2009)
ISBN	:	9781591842859
Author	:	Joshua Kosman
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Genre	:	Economics, Business, Finance, Nonfiction, Currency, Money

From Reader Review The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis for online ebook

Mariellen says

Another alarming book on the state of our economy. This book, along with the other books on recent developments on Wall Street, have made me want to take all of our money out of the stock market and put it in Treasury bills.

I didn't think the book was especially well written even though I found the topic riveting. The author tended to repeat himself and sounded alarmist. Indeed it's a very disturbing scenario -- over borrowing by corporations will lead to another credit crisis when the loans come due starting in a couple of years from now.

The stories about individual corporations that have already filed for bankruptcy, or have been unable to remain competitive because of their enormous debt, were very interesting and, for the most part, well written. In many cases, private equity firms have taken over companies and sucked all of the equity out of them.

I would recommend reading this book if you are interested in the topic. However, I hope a better writer will come out with another book soon.

Davis says

Basic premise of the book: there's another credit crises on the horizon, though slightly smaller than the housing bubble that just passed. This time it is the buying of companies by Private Equity firms, who force the companies being bought to assume debt up to 80% of the purchase price. This debt is scheduled to come due starting 2012 and if credit markets don't improve, then we may see many of these companies going BK, unable to rollover the debt. It's about $1.2 trillion in debt and 2.5 million jobs on the line, according to the author. Some examples of PE-owned companies going bankrupt already: Linens and Things, KB Toys, Mervyn's.

If anything should be regulated, it should be private equity. This is what happens when pure greed is allowed to operate unchecked in capitalism. What's even more disgusting is seeing former presidents, treasury secretaries, etc., working as lobbyists for these firms.

The author's writing could have been better. The book seems a bit unpolished, not entirely cohesive. But the facts are convincing and at times down right pitiful. I don't know how these private equity guys can pat themselves on the back for making all that money. There must be some unwritten rule that mirrors are not allowed in their offices so that they don't have to face themselves.

YHC says

Good, today I learn something totally new!

This is the first time I read about PE (private equity), the first time i get to know it was thought the movie " Pretty Woman", Edward was doing exactly same thing, buying out companies and sell them in pieces with bigger profits.
Kosman was not very optimistic about PE because he thinks they use leveraged buyout (LBO): "A leveraged buyout (LBO) is the acquisition of another company using a significant amount of borrowed money to meet the cost of acquisition. The assets of the company being acquired are often used as collateral for the loans, along with the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital." https://www.investopedia.com/terms/l/...

CLO(Collateralized Loan Obligation)-
A collateralized loan obligation (CLO) is a security backed by a pool of debt, often low-rated corporate loans. CLOs are similar to collateralized mortgage obligations, except for the different type of underlying loan. With a CLO, the investor receives scheduled debt payments from the underlying loans, assuming most of the risk in the event borrowers default, but is offered greater diversity and the potential for higher-than-average returns. https://www.investopedia.com/terms/c/...

EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization'
EBITDA stands for earnings before interest, taxes, depreciation and amortization. EBITDA is one indicator of a company's financial performance and is used as a proxy for the earning potential of a business, although doing so has its drawbacks. Further, EBITDA strips out the cost of debt capital and its tax effects by adding back interest and taxes to earnings. https://www.investopedia.com/terms/e/...

The bad side of PE takes over the bought companies:
The level of service drops, the employees got layoff, the price of product higher, but the quality might get worsen. They would cut down the cost and gain the maximum profits, suck it off into the bone to get whatever useful. After all the propose of PE is to gain the profit, there is nothing emotional or moral as obligation for them to pursue. Business is business.

Kosman thinks that since PE stepped into financial banks, the LBO game will be played even stronger, the regulation is not yet fully on the set after all when the financial crisis comes, the government is always the last hope, and before reaching out the help, government doesn't might to let PE's money step in.
He consider PE itself would cause the next financial credit crisis, the biggest problem would be the regulation and the power of lobbyists. I don't have enough knowledge to understand if Kosman's viewpoint is totally accurate, but i learn something new today and i am glad!

Ed says

This is a good, short (78,000 words), critical analysis of the private-equity industry.

Kosman goes out of his way to treat his subject & interviewees fairly, but he strongly disapproves of the industry:

"I believe the record shows that PE firms hurt their businesses competitively, limit their growth, cut jobs without reinvesting the savings, do not even generate good returns for their investors, and are about to cause the Next Great Credit Crisis. Leadership is needed to rally opposition to close the tax loopholes that make this very damaging activity possible." (15)

"This decade, predictions are that half of all PE-owned companies will collapse. The conclusion: PE firms have largely hurt their businesses in both good and difficult economic times." (194)

"The whole industry was started in order to take advantage of tax loopholes. It was not about, and never has been about, building strong, healthy companies." (195)

"One could reasonably argue that PE firms were significant contributors to the financial crisis that began in 2008, and they are definitely the architects of the one that is coming by around 2012." (201)

The *New York Times* produced several short videos explaining how private-equity works, available here:

http://www.nytimes.com/packages/html/...

read: Sept 2011, July 2016.

Emily says

Frightening book...

Mr. Kosman predicts another financial meltdown in the American economy, circa 2012-ish, this one due to the enormous weight of debt on companies which have been bought out by private equity (PE) firms using leveraged buyouts (LBOs). He backs up his assertions with a great deal of research and detail, enough that I had to reread some passages several times to make sure I comprehended the financial finaglings going on. And I've got an MBA. So take your time working through the minutiae of these deals. Mr. Kosman explains them well; they're just often rather convoluted or contrary to common sense.

The track record of these companies purchased in LBOs by PE firms is abysmal (about half eventually end in serious financial trouble or bankruptcy) and the volume of LBOs has increased markedly during this decade. Mr. Kosman claims that up to 1 out of every 10 workers in the United States is employed by a company owned by a private equity firm. And if half of those 3000 or so companies are unable to manage the huge loan payments coming due in the next few years, it will result in millions of lost jobs because of bankruptcy, downsizing or location closings.

My husband's company was bought by a PE firm in 2007 and the changes Mr. Kosman describes - layoffs; replacing higher paid professional employees with cheaper, less qualified staff, regardless of the effect on patient care or customer service; squeezing the remaining employees for every drop of productivity while decreasing compensation, incentives and "extras"; essentially making everything about the company's bottom line - are exactly what we've seen at his company for the past two years. Very depressing.

But what's more depressing is that those who have the capability to perhaps take some action to prevent or curtail a financial crisis coming from this sector do not seem to have any interest in doing so - it might hurt their chances for employment after they leave public service. Mr. Kosman lists some very simple (not necessarily easy) steps that could be taken to reduce the incentives for PE firms to perform LBOs, squeeze and cripple the companies they buy while extracting enormous amounts of money for fees and dividends, and then flip them before the loans come due. One hopes that someone in Washington listens before it's too late.

For more book reviews, visit my blog, Build Enough Bookshelves.

Yifan (Evan) Xu (Hsu) says

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Cnl26 says

My rating is actually 3.5 stars because I did learn a lot. The book is short but it felt much much longer. Partially because the author provided a lot of detail. Also because the same conclusion was drawn at the end of each chapter; private equity is bad for everyone but private equity firms and things are going to get worse. Going through each chapter only to come to that conclusion makes getting through this book a laborious task.

Kunal says

This was an extremely enlightening book as it is written by a writer for Merger market at the end of 2009 that has taken a very negative approach towards the Private Equity industry in general. He walks through a number of buyouts where the private equity firm’s strategy was to strip out the costs (shed staff, cut R&D spend) and increase cash flow (increase pricing, sell off business’s) etc. While these strategies did increase the cash flow generation of these companies, this cash flow was typically not used to pay down debt but was instead used to pay a shareholder dividend to the private equity owners. As PE firms have a short investment horizon of their investments (3-5 years typically), they are very focused on making these changes as soon as possible and extracting cash from the business as soon as they can in order to begin to realize a return on their initial investment. As these dividend transactions are a function of overall market conditions, there are several examples of company’s taking on additional leverage to pay out a dividend during a hot market. However, the problem with this model is that on a long term basis, the cost stripping has turned out to be detrimental for several of these companies. The cutting of staff left several of these companies understaffed and they started to have poor customer service due to the lack of manpower. Also, there have been several examples of PE firms (ex: Sealy Mattress) increasing pricing until new lower priced competitors come into the market. These strategies have led to these companies experiencing a loss in market share, often after the PE firms have taken dividends out / sold off these companies so they are indifferent towards the long term fate of the company. Also, lets not forget that many of these firms are charging annual management fees so they are already receiving some returns on their investment.

The author does make a point that Private Equity is a lot about financial engineering as opposed to long term value creation. There are several investments whereby the companies were able to breakeven or turn a slight profit, BEFORE taking into count the debt the PE firms put on the company and so therefore they end up filing for bankruptcy due to the leverage put on them. The author argues, letting these companies operate as is or under a strategic would have allowed them to continue to operate but under PE ownership and with the leverage they were forced to file bankruptcy.

Again, everyone agrees the private equity industry is a large part of the capital markets and there is significant demand for the asset class which is why the business model continues to work today. However, just because there is a market for this paper and the banks arranging the financing know that they can sell off the debt to investors who have demand for this paper, is private equity an asset class that should continue to be offered to companies given the precedents of companies downfalling after a private equity investment?

I am highly supportive of the private equity industry, however this book makes us question everything we do on a day to day basis and is an interesting perspective to read about.

SUMMARY

In the fall of 2007, investor David Rubenstein posed a question to a friendly audience at a Washington think tank. "How many industries can you think of right now," he asked, "where America is the dominant player in the world?"

If you guessed financial engineering—the derivatives of subprime mass destruction that would bring markets to their knees a year later, requiring hundreds of billions in government support to prop up a faltering economy— you are close. But not exactly right.

No, the answer Mr. Rubenstein had in mind was private equity. He of course is co-founder of the private-equity firm Carlyle Group. "There are very few industries now where without question we are the dominant player," he said then. "Maybe entertainment in some ways. Maybe some Silicon Valley software-type companies. One of those where we do dominate the global economy is in private equity."

Mr. Rubenstein's self-congratulation is recounted late in "The Buyout of America" by Josh Kosman, a New York Post reporter and veteran financial writer. Mr. Kosman warns that the impending failures of companies owned by private-equity investors—which employ 10% of the private-sector work force—could wreak havoc comparable to that brought by the subprime housing collapse. The reason is that such buyouts are typically financed heavily with debt, which can supercharge profits if things go right while worsening the borrowers' woes if they don't. And nine of the 10 biggest buyouts ever occurred between 2006 and 2008.

The literature of private-equity drama is already rich. It includes vivid narratives such as "Barbarians at the Gate" (1990), about the buyout battle for RJR Nabisco, and the Journal's own Pulitzer-Prize-winning story, also from 1990, about the layoffs, lower wages and suicide that followed the buyout of Safeway Stores by Kohlberg Kravis Roberts & Co.

"The Buyout of America" takes a different approach. It is less concerned with blow-by-blow deal-making or personal stories than with the real-life economic effects of private-equity deals. Mr. Kosman brings to the subject a relentlessly critical approach that is refreshing, simply because so many stories about the buyout firms are the sort of puff pieces that result from delicate negotiations for access. He documents dozens of companies acquired in buyouts—such as hospitals, mattress manufacturers and a car-parts maker—whose service or products went downhill, whose employees suffered pay cuts or layoffs, and whose fortunes plummeted, sometimes ending in bankruptcy.

Time and again, Mr. Kosman details how the rest of us suffer at the hands of the buyout barons, 17 of whom are members of the Forbes 400. The private-equity firms pay lowball prices, he says, shortchanging public investors, by teaming up with management to pre-empt competing bids. They cream fees from their acquisitions, generating profits no matter how the companies fare. The companies cut more jobs than publicly owned competitors and sidestep proposed reforms by currying favor with politicians. Mr. Kosman finds a University of Chicago study showing that, for the years 1980 to 2001, the private-equity firms' investors got returns that fall short of the broad market average, after fees.

Mr. Kosman provides exhaustive specifics. Linens 'n Things is acquired in a buyout by Apollo Management, led by deal maker Leon Black, files for bankruptcy and is liquidated. Nursing staff is cut at a Vanguard Health Systems hospital, owned by Morgan Stanley Capital Partners. Regulators fine for poor service a Hawaiian phone company acquired by Carlyle. Warner Music loses Madonna. At Bain Capital, built by former presidential candidate Mitt Romney, dividends paid to investors siphon off much-needed capital, weakening company after company. Jobs at a unionized Sealy mattress plant in Memphis, Tenn., are shifted to a lower-wage, nonunion plant in Texas. Research spending is cut at Baxter International. Another Bain company replaces a traditional pension plan with a less favorable cash-balance plan.

But Mr. Kosman undercuts his wealth of material with a one-sided approach and strident tone. He decries the "greed and grossly shortsighted management policies" of private-equity owners. He says such owners often "starve their businesses of both human and financial capital, and the companies suffer." For all that, he generally doesn't interview the biggest buyout figures, like Henry Kravis, Stephen Schwarzman of Blackstone Group, Mr. Black or even their PR agents. Instead, he gets a few B-list interviews with Joseph Rice of Clayton, Dubilier & Rice or Scott Sperling of Thomas H. Lee, who gamely make the case that private equity helps companies. Even Carlyle's Mr. Rubenstein, described as "the self-appointed spokesman for the PE industry," declines to allow Mr. Kosman to quote from two background interviews he granted in 2007 and 2008—before the subprime-debt deluge.

Stepping back, Mr. Kosman doesn't address the larger capital-markets context either. The private-equity managers invest for many of the same pension funds that own huge chunks of the stock market, and in some ways their approach to established companies is the opposite of the heady, business-building "growth story" embraced at initial public offerings. When a company matures or technology changes, spending on ineffective growth initiatives may be a waste of assets for a business that is more likely reaching its sell-by date. Private-equity managers may ultimately serve as more draconian agents of "creative destruction" who eventually redirect capital, assets and jobs to higher-growth opportunities.

Brian Morton says

Another depressing book about what is affecting today's economy. It shines light on the exploitation of a tax loop hole by Private Equity Firms (which should be called Parasitic Greed Mongols). Essentially what these firms are doing is buying companies and striping them down by selling off assets, laying off workers, reducing R&D spending, and reducing/degrading services provided. After stripping the company they are able to show large (short time) profits. They then present extrapolated profit projections to unknowing/uncaring banks which allow them to take out huge loans. We are talking hundreds of millions to billions of dollars. With these loans they sparsely reinvest in the company, pay out dividends to shareholders, and then line their pockets with the rest by paying themselves fees. They then attempt to sell these companies and let someone else deal with the problems that ensue. By loading these companies with so much debt and investing so little back into them, they cripple them and many of them fail and default on the loan. Even if they can't sell the companies before their decline they still walk away with large profits because of the exorbitant sums of fees that they have paid themselves.

How does this affect you? Well for one these are very large companies which employ thousands of employees. Not only do they initially do mass layoffs, but also make many of the companies fail which leaves the rest of the employees jobless. Also these loans act as tax shelters since these companies which do hundreds of millions in sales end up WRITING OFF ALL THEIR TAXES. We are talking about the government missing out on perhaps billions in tax revenues. Wondering why we are so short on all our governmental budgets? Most of these loans will become due between 2012 to 2015, when the companies cannot pay they will have to either be bailed out or close shop leading to another dip in our economy. Not only that, these private equity firms are buying health care businesses and stripping them down of services, firing nurses and hiring nurses assistants in their place, lowering the standards of our overall health care system, all so they can line their pockets with fast cash.

If you are wondering why MITT ROMENY is so good at fund raising it is because he is not only a supporter of these Parasitic Greed Mongols (Private Equity Firms) but he is also a co-founder of one of them. He co-founded Bain Capital which practices these ill reputed tactics to make themselves rich, very rich. Do you see a conflict of interest if he is elected president? He will no doubt make sure these very faucets of wealth remain flowing, siphoning from business's assets and your tax dollars, showering his and his partners private vaults.

[image error]

Ralph Orr says

An important economic and social topic. However, I care not for journalistic-style books: which are filled with personal stores. This is not biography or history. So I skipped much of the text, and still understood his main points; that historically the majority private equity deals have lead to the bankruptcy of the companies taken-over, while simultaneously enriching the private equity firms. American workers others suffer greatly. Rarely does a taken-over firm emerge better off for the long-run. These take over deals are often funded with large amounts of debt. The author believes that unless the economic improves significantly, many taken-over companies are going to go bust between 2012 and 2015, adding many more to the unemployment roles. If he is wrong, the book is immediately out-of-date by mid-2012. If he is right, he will be hailed as the unheeded prophet. The three-star rating is based on my view of his writing style, and the book's short-term usefulness.

Thom Slattery says

Good overview on how LBOs work and the damage some have caused to the economy. The language was easy enough to understand without a strong background in economics. While I frequently had to re-read sections to fully get the deals and how they proceeded, the book was light enough that it didn't feel like dragging.

I would have preferred some more in-depth analysis comparing the fates of these companies and those that were not taken over by private equity. In many cases it was hard accept the judgment by Kosman that a deal was clearly bad - even a chart here and there normalizing profits, etc. might have better illustrated things.

Daniel says

A very interesting look around the next corner of the financial crisis where few (if any) analysts/economists/pundits have yet even discerned that there is weakness. Kosman does a very good job laying out the nature of Private Equity companies and showing direct examples of the harm they have done in the past before making his case for the powder keg they appear to be lighting in the present. Of particular interest is how these PE/LBO (leveraged buyout) entities are able to harm normally productive and profitable American businesses at potentially the most precarious time in our history since the 1930's. Just when we need American industry to be at its strongest, these termites enter and consume the timbers of intra-national business from the inside out leaving in their wake, unemployment, lost communities, wasted infrastructure and shells of the former enterprises they've taken over.

Written in a way that both encapsulates and documents the issues properly while not making the information inaccessible to the layman, Josh Kosman has done a notable service to his readers. Whether or not his predictions of a Next Great Credit Crisis at the hands of PE prove to be true, his detailed explanations of the moral hazard at play and the crippling after-effects of the Leverage Buyout barons in America make this a worthwhile read for anyone interested in how nuanced and complicated our financial system really has become. He has successfully opened a doorway where the common man is not usually granted entry with the disclaimer in place that behind the door, we are far more likely to find the tiger than the lady we were promised.

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itpdx says

In retrospect, when mortgage credit disintegrated, we saw that there had been a few voices raised in warning.

Kosman is raising a voice about the next credit catastrophe.
Private equity (PE) firms went on a buying binge in the late 90's and early 00's. They had the companies that they bought borrow most of the money the PE firms used to buy them. The banks that lent the money applied less than rigorous standards in approving the loans because they would resell them (sound familiar). The PE firms try to improve the position of the purchased company by short-sighted management in order to re-sell or take the company public in 5 or 6 years. Of course recent conditions have not been conducive to this and some of the highly leveraged companies have gone bankrupt. And many of the loans will start coming due in 2012. Read this book to see how the PE firms still make money even when they drive their "investments" into bankruptcy and why our public employee pension funds are at high risk of becoming under-funded because of this.
Kosman offers some suggestions on what Congress and the administration can do to somewhat cushion the blow but also gives a pessimistic out-look of these changes being made because of the influence that PE firms have in Washington.
The book gives evidence of having been rushed to press--editing errors and sections that are a little skeletal, but it is definitely an infuriating and important read.

Chris says

I was very impressed with the attention to detail in this book. Its rare to find a journalist who trusts his readers enough to give technical summaries of his subjects. Without understanding the legal and financial aspects of these LBOs it would have been difficult to comprehend the breadth of the problem.

Lobstergirl says

When the bad press about LBOs (leveraged buyouts) and the destruction they left in their wake made LBO a dirty acronym, the industry gave itself a new name: private equity. Private equity firms like to pretend that they make companies leaner, stronger, and more efficient, but what they do most of the time is make them leaner, weaker, starve them of capital (the capital they suck out goes into dividend payouts) while saddling them with debt, emphasize short-term over long-term profits, fire lots of employees, and often, drive them into bankruptcy. The PE firms' partners always come out ahead, though: they guarantee themselves huge fees and profits upfront. Kosman estimates that between 2000 and 2008, about 500,000 Americans lost their jobs because PE firms had bought their employers and were cutting costs. The scariest stories are where PE takes over hospital chains and reduces staff. You can imagine what happens. The incredibly high costs of mattresses made by Sealy and Simmons can be traced to PE, which drove prices higher to increase revenues, even as they lost market share. 10% of all private sector employees work at companies owned by private equity firms, meaning that if PE's fairly dismal track record continues, that's a lot of jobs in danger. And between 2012 and 2015 $700 billion in loans borrowed by PE owners will come due, which, Kosman argues, will produce "the next great credit crisis" and plunge many of those companies into bankruptcy.

"Still, after enough PE-owned companies go bankrupt, the public will be looking for answers." They will? I think that's being optimistic. Most of the public probably has never heard of private equity, or if they have, have little notion what it means. The mainstream media might tell us when a company goes bankrupt, but you'll rarely ever hear the gritty details - whether it was owned by private equity, how and why it went bankrupt, how the tax deductibility of interest payments on debt makes PE buyouts so enormously appealing and easy in the first place.

How difficult is it to regulate PE? Aside from the lobbyists, consider that Barney Frank, chair of the House Financial Services Committee, is a fan of PE; Chuck Schumer and his chairman on the Senate Banking Committee, Chris Dodd, are big fans of Wall Street; four of the past eight Treasury Secretaries joined the PE industry (James Baker, Nicholas Brady, Paul O'Neill, and John Snow); Bill Clinton and both Bushes have advised PE firms.

There are a few chapters (the last three in particular) where Kosman could have made the story more cohesive and less rambling. There were also certain companies I would have liked to see him focus more closely on, such as Kinko's. We learn that from 1996 to 2004, when Kinko's was owned by private equity, cutting back on customer service was a primary management strategy - but that's all we're told. Overall, though, this is a horrifically enlightening read and a well-told tale.

The PBS Newshour did a story on the book and an interview with the author which you can watch here: http://www.pbs.org/newshour/bb/busine...
